Nos. 89-1452, 89-1453

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

MOBIL OIL EXPLORATION AND PRODUCING SOUTHEAST, INC., *et al.*,
Petitioners,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
v.
UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF AMICI CURIAE OF THE STATES OF NEW MEXICO, LOUISIANA, TEXAS, OKLAHOMA, AND WYOMING IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

This brief addresses the following issues:

(1) Whether the Federal Energy Regulatory Commission permissibly interpreted its authority under Sections 104(b)(2) and 106(c) of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3314(b)(2) and 3316(c), to eliminate "vintaged" ceiling prices for "old" natural gas and establish a single maximum ceiling price for all such gas.

(2) Whether the Commission permissibly interpreted its authority under Section 7(b) of the Natural Gas Act ("NGA"), 15 U.S.C. § 717f(b), to allow abandonment of regulated sales of natural gas by independent producers on a pre-granted basis.

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BRIEF AMICI CURIAE OF THE STATES OF NEW MEXICO, LOUISIANA, TEXAS, OKLAHOMA, AND WYOMING IN SUPPORT OF PETITIONERS

INTRODUCTION

The States of New Mexico, Louisiana, Texas, Oklahoma and Wyoming submit this brief in support of the Federal Energy Regulatory Commission and the Mobil Oil Exploration and Producing Southeast, Inc. parties. The decision of the Fifth Circuit in *Mobil Oil Exploration and Producing Southeast, Inc.* v. *Federal Energy Regulatory Commission*, 885 F.2d 209 (1989), should be reversed.

INTEREST OF THE AMICI CURIAE

The *amici* states submit this brief as *amici* curiae in support of the petitioners in this case, the Solicitor General on behalf of the Federal Energy Regulatory Commission ("Commission") and Mobil Oil Exploration and Producing Southeast Inc. *et al.* ("Producers"). The Commission and the Producers seek reversal of the decision of the United States Court of Appeals for the Fifth Circuit in *Mobil Oil Exploration and Producing Southeast Inc.* v. *FERC*, 885 F.2d 209 (5th Cir. 1989).[1] The *amici* states, individually and collectively, have a vital interest in the questions presented by this case, which revolve around a common issue: in enacting the NGPA, to what extent did Congress intend to grant the Commission discretion to raise the ceiling price for some "old" gas, in order to eliminate distortions in the natural gas market, and to permit market forces to play a greater role in the regulation of sales of natural gas in interstate commerce? In the NGPA, Congress expressed a preference for the operation of market forces to play a significant role in the regulation of producer sales of natural gas; at the same time, Congress retained comprehensive regulation of interstate pipeline sales and service, in recognition of the pipelines' inherent monopoly characteristics.

Much of the natural gas produced and sold in the United States is produced from the *amici* states. Much of the *amici* states' production occurs from state lands. The *amici* states are responsible for the management of the state lands, and in particular the natural resources, including natural gas, that underlie those lands. The *amici* states all have the responsibility, under state laws, to prevent waste, protect the correlative rights of mineral interests owners, and promote the orderly development of production. Although the natural gas industry is subject

[1] This brief of amici curiae is filed pursuant to Rule 37.5 of the Rules of the Supreme Court.

to federal regulation under both the NGA and the NGPA, both of these statutes exempt the "production and gathering" of natural gas under Section 1(b) of the NGA, 15 U.S.C. § 717(b). This Court has held that Section 1(b) reserves to the states the authority to enact laws and regulations aimed at the prevention of waste and the protection of correlative rights. *Northwest Central Pipeline Corporation* v. *State Corporation Commission of Kansas*, 109 S.Ct. 1262 (1988); *Transcontinental Gas Pipe Line Corporation* v. *State Oil and Gas Board of Mississippi*, 474 U.S. 409 (1986). In addition, as royalty owners, the *amici* states are responsible for recovering the maximum amount of natural gas possible from state lands, at the full value of that gas. Moreover, as taxing authorities, the *amici* states are responsible for ensuring the full recovery of all gas produced within the state, whether or not from state lands, and the full value of the gas produced in the states.

The Commission issued Order No. 451 in 1986 to remedy the severely distorted pricing structure that resulted from the "old" natural gas vintaging. By the time the Commission issued Order No. 451, this distorted pricing structure had contributed to the emergence of contract disputes between producers and pipelines over pricing and take requirements on virtually an industry-wide basis. Order No. 451 collapsed the sixteen existing "vintages" for "old" gas, and established a single "alternative" ceiling price for such "old" gas equal to the highest price ceiling among the vintages. Under Order No. 451, producers are not automatically entitled to the alternative maximum lawful price. Producers under specified contracts simply are eligible to collect *up to* that ceiling price, further contingent upon agreement by the purchasers or compliance with a "Good Faith Negotiation" ("GFN") procedure set forth in the order and codified in the regulations. Among other things, as part of the GFN procedure, producers must offer to reduce the

price of "new," generally higher-cost natural gas sold under the same contracts as old natural gas. By so limiting the producers' ability to collect higher prices for old gas, the Commission sought to balance the bargaining positions of gas producers vis-a-vis the interstate pipelines. Through this balance, the Commission sought to avoid dramatic disruptions to the marketplace and to encourage production of low-cost gas.

Industry data suggest that this balancing has worked. The Commission has indicated that gas producers and pipelines have renegotiated thousands of natural gas contracts under Order No. 451. Some of these renegotiations include omnibus settlement of contract liability between producers and pipelines, ending disputes that have dragged on for the better part of a decade. In many instances, gas under those contracts was repriced to reduce the price of some categories of gas at the same time some old gas prices increased. Order No. 451 provided many smaller producers, who typically do not have the leverage necessary to bargain successfully with a major interstate pipeline, with an important bargaining chip that enabled them to obtain release of captive "old gas." Data also indicate that since Order No. 451 has been in effect, natural gas prices at the wellhead have declined. The Energy Information Administration, U.S. Department of Energy, reported that the average wellhead price for natural gas based on available data has declined from $1.94 per Mcf in 1986, the year Order No. 451 became effective, to $1.71 in 1989. Energy Information Administration, *Natural Gas Monthly*, March, 1990 (DOE/EIA-0130 (90/03)), at 32. Duing the same period, total dry gas production increased from 16.536 Tcf to 17.102 Tcf,[2] and consumption increased from 16.221 Tcf to 18.956 Tcf.[3]

[2] *Id.*, at 28.

[3] *Id.*, at 30.

Order No. 451 is critically important to the *amici* states.[4] It permits increases in and rationalizes old gas prices and provides authority for the release and resale of old gas to new markets. Order No. 451 has encouraged the production of old gas, which prevents the permanent loss of the old, low-cost gas. Additional production in turn increases the royalty and tax revenues from such gas. Although Order No. 451 also decreases the prices for new gas, which in turn reduces the royalty and tax revenues on sale of such gas, the *amici* states supports the Commission's goal of relieving the price distortions inherent in old gas vintaging. Ultimately, the *amici* states believe that Order No. 451 will result in vastly enhanced recovery of inexpensive and nonrenewable gas, which will benefit the *amici* states, consumers, the Nation's economy as a whole and the environment.

The Fifth Circuit's decision creates the potential for continuing fiscal uncertainty and tremendous administrative burdens for the *amici* states, as well as dramatic disruption to gas markets. Order No. 451 took effect on July 30, 1986, over four years ago, and has been effective continuously ever since. Although precise figures are not

[4] As Justice Douglas commented in his dissenting ouinion in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), the first of several opinions by this Court on review of experiments by the Federal Power Commission to set producer rates following this Court's decision in Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954):

> Now that *Phillips* has put the prices of producers under federal control, the interests of the producing States must be considered, appraised and weighed as an important ingredient of the "public interest." Regulation of wellhead prices by the Commission directly influences the level and feasibility of production, and can significantly affect the producing States' regulation of production. See Phillips Petroleum Co. v. Wisconsin, *supra*, at 689-690 (dissenting opinion).

Permian Basin Area Rate Cases, *supra*, 390 U.S. at 747 (Douglas, J., dissenting).

available, industry sources have estimated that producers and pipelines have renegotiated thousands of gas sales contracts covering hundreds of millions of dollars in accrued liability under Order No. 451.[5] In addition, a significant spot market for short-term sales of gas has developed over the past few years, in part as a result of the Commission's efforts to restructure the industry. Much old gas was "released," either permanently or temporarily, from long-term contracts, and sold on this spot market to new purchasers under "new" (post-July 30, 1986) contracts. Order No. 451 makes such release and resale possible by providing for pregranted abandonment under NGA Section 7(b), 15 U.S.C. § 717(b), of long-term sales of old gas. Old gas sold on the spot market under new contracts is eligible for the alternative price ceiling established in Order No. 451.

In general, the *amici* states collect royalty based on the value of the natural gas produced from state lands, and severance taxes based on the value of all wellhead sales of natural gas within the states. Since Order No. 451 took effect, the prices of "old" natural gas have increased, approximately to the spot market price level, not the "alternative" ceiling established by the Commission. At the same time, new gas prices have declined, in part as a result of Order No. 451.[6] The reversal of Order No. 451 could cause a fiscal crisis for the *amici* states. The administrative burdens on the states to even calculate the royalty and tax revenues attributable to Order No. 451

[5] Order No. 451 does not require producers and pipelines to utilize the GFN procedure to renegotiate contracts. Indeed, in Order No. 451, the Commission delayed the effective date for commencement of the GFN procedure until November 1, 1986, to allow parties to attempt renegotiation outside of the GFN procedure. Order No. 451, *mimeo* at 45; R. 5437. Although the *amici* states' information is largely anecdotal, it appears that the GFN procedure was invoked only in the minority of renegotiations.

[6] EIA, *Natural Gas Monthly*, March, 1990, *cited supra*, at 35-36.

are immense. In addition, the invalidation of Order No. 451 raises the specter of "shut in" production, and the loss of trillions of cubic feet of natural gas underlying state lands because the production is no longer economically viable.

Perhaps more fundamentally, the *amici* states are concerned about the implications of the Fifth Circuit's decision for the Commission's largely successful initial efforts at restructuring the natural gas industry to respond to the dramatic changes the industry has undergone since the enactment of NGPA. Over the past five years, as this restructuring has occurred, consumers have benefitted from more-than-adequate supplies at ever-lower prices. The Fifth Circuit's decision would not only remove a vital component of the restructuring at a critical turning point in the modern history of the gas industry; the implications of the decision may undermine the Commission's efforts in other regulations to respond to the new market forces. This case raises fundamental questions with respect to the Commission's role in regulating the natural gas industry under both the Natural Gas Act and the NGPA.

SUMMARY OF ARGUMENT

1. The NGPA authorized the Commission to promulgate Order No. 451. 15 U.S.C. § 3314(b)(2); 15 U.S.C. § 3316(c). Not only does the NGPA provide, in plain terms, authority for the Commission to increase old gas prices by rule or order; the NGPA represents a Congressional compromise between competing regulatory philosophies. Congress intended that under the NGPA, the Commission would seek to channel market forces to address the market disruptions that had occurred under traditional utility-type regulation of producers. Order No. 451 is an inevitable outgrowth of that intent. Significantly, almost three years to the day after Order No. 451 became effective, the Congress enacted legislation which will

completely decontrol all gas subject to the orders on review by 1993. Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60; 103 Stat. 157; 15 U.S.C. §§ 3331(f), 3431(a)(1)(E). In enacting this legislation, Congress did *nothing* to disturb Order No. 451; indeed, Congress' decontrol of all gas subject to the rule implicitly sanctions the rule.

2. The same legal standards and basic logic apply to the component of Order No. 451 that authorizes pregranted abandonment under Section 7(b) of the NGA. Contrary to the Fifth Circuit's decision, pregranted abandonment does not contradict prior decisions of this Court. Moreover, pregranted abandonment is essential for effective use of market forces following enactment of the NGPA. The Congress expressly intended that the NGPA would limit the Commission's NGA authority over producer sales of gas, as well as prior decisions of the Court. The Fifth Circuit's decision to limit the Commission's flexibility to grant abandonment under the NGA contradicts the intent of Congress under the NGPA and undermines the Commission's authority to restructure the industry to achieve the goals established by Congress in the NGPA. The 1989 Act, cited above, eliminates service controls over old gas effective January 1, 1993.

ARGUMENT

I. THE CONGRESSIONAL INTENT UNDERLYING THE NGPA SUPPORTS ELIMINATION OF VINTAGING.

The NGPA embodies "[t]wo conflicting legislative resolutions" to the natural gas shortages that developed in the 1970s in the interstate market. *FERC* v. *Martin Exploration Management Company*, 486 U.S. 204, 207 (1988). Under the NGA, 15 U.S.C. §§ 717, *et seq.*, the Commission's authority extended over all producer sales for resale in interstate commerce. The NGPA was enacted in 1978, after an acute shortage of natural gas during the 1970s prompted Congress to revise the statutory scheme. "To encourage production, the NGPA took wellhead sales of 'new' and 'high-cost' gas outside the coverage of the NGA . . . and provided instead for market-driven wellhead pricing, at first up to a ceiling, and later with no ceiling." *Northwest Central*, 109 S.Ct. 1262, 1269. Old gas, dedicated to interstate commerce prior to enactment, was to remain forever subject to price and service controls.[7] The Congress sought to eliminate price controls for future production of natural gas to provide an incentive to stimulate needed production, based on Congress' recognition that market incentives were more effective than regulatory rate-setting to bring forth such supplies. Congress also provided in the NGPA for the elimination of the differentials between the interstate and intrastate markets, by creating a single federal pricing scheme for interstate and intrastate gas, and eliminating barriers to transportation and sales between intrastate and interstate commerce.[8]

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[7] Under the Natural Gas Wellhead Decontrol Act of 1989, 15 U.S.C. §§ 3331(f), 3431(a)(1)(E), NGPA price ceilings and NGA certificate and abandonment requirements for old gas are now in the process of being phased out as well, with complete elimination of all wellhead price and service controls effective January 1, 1993.

[8] *See* NGPA Sections 105 and 106(b), respectively, 15 U.S.C. §§ 3315 and 3316(b), and Section 311, 15 U.S.C. § 3371.

1. Since enactment of the NGPA, the Commission has pursued policies that attempt to achieve the goals of the NGPA and respond to evolving market conditions. This has proven a challenging task because of rapid and substantial changes in the industry. The record in this proceeding and numerous studies have documented the sudden emergence, after enactment of the NGPA, of a substantial oversupply of nautral gas (the "gas bubble"). This gas bubble created pressure, both on producers and pipelines, to retrieve markets lost to natural gas during the shortage years of the 1970s and to locate new markets. The Commission worked to facilitate those efforts, in part to protect consumers from large rate increases that would result from the potentially burgeoning liability of some major interstate pipelines to their producer-sellers,[9] and in part because such efforts exploited market forces, consistent with the NGPA.[10]

a. Order No. 451 is one of several rulemaking orders in which the Commission sought, within the limits of its statutory authority, to effectively respond to the

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[9] As this Court noted in *Martin Exploration, supra*, many of the interstate sales contracts between producers and pipelines in effect at the time of the NGPA contained pricing provisions that authorized the producer to collect the applicable NGPA ceiling price for any new gas produced under the contract after enactment. *Martin Exploration*, 486 U.S. at 210. Even as production of gas increased rapidly in response to enactment of NGPA, the ceiling prices continued to increase with inflation, until the ceilings were far in excess of realistic then-current market levels. This development was aggravated by "take-or-pay" clauses in these contracts, which require the purchasing pipeline "either to purchase a specified percentage of the producer's deliverable gas or to make 'prepayments' for that percentage anyway." Associated Gas Distributors v. FERC, 824 F.2d 981, 1021 (D.C. Cir. 1987), *cert. denied*, 108 S.Ct. 1468 (1988); *see also*, Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board, 474 U.S. 409, 412 (1986).

[10] Order No. 451, *mimeo* at 74; R. 5466. *See, generally*, Pierce, *Reconstituting the Natural Gas Industry From Wellhead To Burnertip*, 9 Energy L.J. 1 (1988).

changes in the industry brought about by enactment of the NGPA. In the Commission's Order No. 436, issued in 1985, the Commission established an "open-access" blanket natural gas transportation program, under which interstate pipelines may apply for and receive blanket certificates to transport gas for others.[11] In Order No. 490, issued in 1988, the Commission established a pregranted abandonment rule, by which producers may abandon sales to interstate pipelines and sell that gas to others without the need to seek individual prior approvals.[12] The conceptual underpinnings of these programs had evolved over a considerably longer time, on an individual company basis.[13]

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[11] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. and Regs. [1982-1985 Regs. Preambles] (CCH) ¶ 30,665, 50 *Fed. Reg.* 42408 (October 18, 1985) (Order No. 436), *on rehearing*, FERC Stats. and Regs. [1982-1985 Regs. Preambles] (CCH) ¶ 30,675, 50 *Fed. Reg.* 52217 (December 23, 1985) (Order No. 436-A), *on rehearing*, III FERC Stats. and Regs. ¶ 30,688, 51 *Fed. Reg.* 6398 (February 24, 1986) (Order No. 436-B), *vacated and remanded*, Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied sub nom.* Southern California Gas Company v. FERC, 108 S.Ct. 1468 (1988); *on remand*, Regulation of Interstate Pipelines After Partial Wellhead Decontrol, III FERC Stats. and Regs. ¶ 30,761, 52 *Fed. Reg.*, 30334 (August 14, 1987) (Order No. 500), *on rehearing*, III FERC ¶ 30,772, 52 *Fed. Reg.* 39630 (October 23, 1987) (Order No. 500-B), *vacated and remanded*, American Gas Association v. FERC, 888 F.2d 136 (D.C. Cir. 1989), *on remand*, III FERC ¶ 30,867, 54 *Fed. Reg.* 52344 (December 21, 1989), *on rehearing*, III FERC ¶ 30,880, 55 *Fed. Reg.* 6605 (February 26, 1990), *review pending*, American Gas Association v. FERC, No. 87-1588 (D.C. Cir., Argued May 8, 1990).

[12] Abandonment of Sales and Purchases of Natural Gas Under Expired, Terminated or Modified Contracts, III FERC Stats. and Regs. ¶ 30,797, 53 *Fed. Reg.* 4121 (February 12, 1988) (Order No. 490), *reh'g denied and clarified*, III FERC ¶ 30,825, 53 *Fed. Reg.* 29002 (August 2, 1988) (Order No. 490-A), *review pending*, Marathon Oil Company v. FERC, No. 88-3666 (6th Cir., filed July 26, 1988).

[13] *See e.g.*, Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985); Maryland People's Counsel v. FERC, 765 F.2d 450

b. The Commission's regulatory restructuring has adapted to the transformation that the gas industry has undergone over the past decade. In 1978, virtually all natural gas sold in interstate commerce was sold by producers to pipelines for resale under long-term contracts, priced at federally-established ceilings. Today, the overwhelming majority of natural gas is sold directly by producers to local utilities and end-users under short-term contracts. The pipeline functions primarily as a transporter only, not a merchant middleman as in the past. A flourishing spot market now exists, in which gas prices and service are determined by competing fuels, including competition between natural gas supplies. As data compiled by the Energy Information Administration shows, consumers have benefitted from all of these developments. Prices at the wellhead have declined steadily throughout this period, and these declines have been reflected at the "burner tip," or point of consumption.

Order No. 451 is an essential component and a logical progression in the Commission's restructuring program. With the second phase of wellhead decontrol under the NGPA effective on January 1, 1985, approximately fifty percent of all volumes of gas sold at the wellhead were price-decontrolled. By collapsing the vintages of old gas, the Commission sought to rationalize the pricing structure, and by doing so, to encourage the production of old, low-cost gas. Further, by allowing for pregranted abandonment upon termination of sales (either by settlement or utilization of the GFN procedure), the Commission provided both producers and pipelines needed flexibility to escape long-term contracts that no longer functioned effectively. Order No. 451, *mimeo* at 147-149; R. 5539-5541.

c. Viewed in the context of the Commission's other regulatory initiatives and the record developed by the

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(D.C. Cir. 1985); Kansas Power & Light Co. v. FERC, 851 F.2d 1479 (D.C. Cir. 1988).

Commission in the Order No. 451 proceeding, the determination to eliminate vintaging is amply supported. The Commission's fundamental duty is to ensure adequate supplies of natural gas at just and reasonable prices. The enactment of the NGPA reflects recognition by Congress that market forces provide an effective incentive to producers to stimulate supply development. In eliminating vintaging, the Commission considered the effects of the surplus and the Commission's open-access policy on newer "high-cost" natural gas. Under the NGPA, old, low-cost gas was shut-in. Pipelines took new gas in preference, largely because of take requirements. Thus, the fact that "old" gas was low-priced was not serving the interests of consumers; much old gas was not moving in interstate commerce, and was in danger of permanent loss.

Based upon these findings and the Commission's objectives, Order No. 451 sought to rationalize the marketplace by eliminating vintaging and establishing a single maximum lawful price for old gas. The Commission found, based on data in the record, that a higher maximum lawful price was necessary in order to avoid the irretrievable loss of up to 11 Tcf of old gas, equal more than half of all domestic production for a full year. Order No. 451, *mimeo* at 115, R. 5507; 126, R. 5518; 131, R. 5523. As stated in the introductory section, the *amici* states have an interest in avoiding the loss of gas underlying state lands, and lands subject to taxation and regulation by the state.

2. In order for interstate pipelines to husband indefinitely their contracted supplies of less-expensive gas, it is often necessary to reduce takes dramatically, or shut-in the supplies completely. Shut-in can lead to drainage, as the gas migrates to other wells (which might not be Section 104 gas wells), or loss altogether as the gas bearing formations fill with water or some other substance that makes extraction prohibitively expensive, or impossible. In Order No. 451 and orders preceding

Order No. 451, the Commission determined that promoting recovery of this old gas, even at prices higher than the original vintage prices, was necessitated by the NGA's requirement that the Commission ensure development of adequate supplies at the just and reasonable prices. As stated, above, data generated by EIA have borne out the correctness of the Commission's analysis.

3. The alternative maximum lawful price established by the Commission is just and reasonable under the NGA, and within the Commission's authority under NGPA Sections 104(b)(2) and 106(c). The Fifth Circuit and the opponents of Order No. 451 have made much of the argument that prior to Order No. 451, the Commission had never before applied replacement cost methodology in setting ceiling prices for "flowing gas" from wells already drilled and completed. The opponents overlook several key points. First, even accepting, *arguendo*, that Congress did not intend to authorize a generic elimination of vintaging, Congress did not lock the precise vintages in existence in 1978 into stone in the NGPA. To conclude that the vintages are inviolate reads Sections 104(b)(2) and 106(c) out of the NGPA. As a general matter, statutes must be read to give harmonious meaning and effect to all provisions. *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979).

Second, the history of vintaging contradicts any claim that the methodology could not be experimented with in changed circumstances. As this Court stated in *Permian Basin Area Rate Cases*, which affirmed the Commission's abandonment of individual company unit cost computations in favor of area rate proceedings, "the Commission is not . . . forbidden 'to adapt [its] rules and practices to the Nation's changing needs in a volatile, changing economy.'" 390 U.S. at 759, *quoting American Trucking Association* v. *Atchison, Topeka & Santa Fe Railroad Company*, 387 U.S. 397, 416 (1967). On its face, the NGPA not only authorizes but requires the Commission to reassess old gas prices in the dramatically changed

gas industry of the 1980s. Seen in context, the Commission's actions are amply supported by the NGPA.

4. Congress has not intervened to "correct" Order No. 451, despite the opportunity; Order No. 451 has been effective for four years. Congress' only action on wellhead pricing during this time period was enactment of the Natural Gas Wellhead Decontrol Act of 1989 (the "1989 Act"). The 1989 Act eliminates all wellhead pricing and service obligations as of January 1, 1993, and provides for interim wellhead decontrol between July 26, 1989, and January 1, 1993, for certain categories of old gas.[14] This Court has held that "the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong, *especially when Congress has refused to alter the administrative construction.*" *CBS, Inc.* v. *FCC*, 453 U.S. 367 (1981) (emphasis added), *quoting Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969) (footnotes omitted); *Zemel* v. *Rusk*, 381 U.S. 1, 11 (1965). Deference to an agency's interpretation of the statute it is charged to implement "is particularly appropriate where . . . [the] agency's interpretation involves issues of considerable public controversy, *and Congress has not acted to correct any misperception of its statutory objectives.*" *CBS*, 453 U.S. at 382 (emphasis added), *quoting United States* v. *Rutherford*, 442 U.S. 544, 554 (1979).

In enacting the 1989 Act, the Congress expressly acknowledged the promulgation of Order No. 451 three

[14] Specifically, Section 2(a) of the 1989 Act eliminates price and service controls over first sales prior to January 1, 1993, for: (1) gas as to which no first sales contract applies on the date of enactment (July 26, 1989); (2) gas under existing contracts, as those contracts expire or are terminated; and (3) gas under existing contracts that the parties renegotiate, after March 23, 1989, to provide that the gas will not be subject to any maximum lawful price. 15 U.S.C. § 3331(f). In addition, gas produced from wells newly-spudded after July 26, 1989, the date of enactment, is deregulated effective May 15, 1991.

years earlier. The Senate Report noted with approval Commission initiatives, including Order No. 451, that, along with court decisions and market pressures, "have stimplated competition in the natural gas pipeline industry that has created opportunities for all classes of natural gas consumers to share in the benefits of the decline in wellhead prices." S.Rep. No. 39, 101st Cong., 1st Sess. 6-7 (1989). The House Report, while not specifically identifying any Commission policy, contains a similar statement. H.R.Rep. No. 29, 101st Cong., 1st Sess. 6 (1989). Although the Court is "chary of attributing significance to Congress' failure to act, a refusal by Congress to overrule an agency's construction of legislation is at least some evidence of the reasonableness of that construction, particularly where the administrative construction has been brought to Congress' attention through legislation specifically designed to supplant it." *United States* v. *Riverside Bayview Homes*, 474 U.S. 121, 137 (1985). Rather than attempting to supplant the Commission's interpretation of the NGPA, the 1989 Act implicitly *endorsed* Order No. 451, taking the final step toward application of market forces to old gas pricing.

5. Finally, the Commission does not permit producers to collect the alternative maximum lawful price absent a voluntary renegotiation or utilization of the GFN procedure, to ensure that the renegotiated price would not exceed market price *or* replacement cost levels, whichever is *lower*. Order No. 451, *mimeo* at 113; R. 5505. Moreover, the alternative maximum lawful price ceiling itself was codified in the NGPA as an old gas price. That price, $2.57 per MMBtu in July, 1986, and $2.98 per MMBtu in July, 1990, is well above the spot market price.[15] The contracts affected by Order No. 451 did not

[15] The Senate Report on the 1989 Act stated that average wellhead prices had declined from $2.66 per Mcf in 1984 to $1.70 in 1988. The average wellhead price would include long-term contract prices as well. The long-term prices tend on average to be *higher* than spot market prices. Thus, if anything, the $1.70 figure is probably inflated. According to EIA's March 1990 Natural Gas Monthly, the annual average was $1.68 per Mcf in 1988, and $1.71 in 1989. In 1989, according to EIA, the average price for old gas was $1.69. *Id.*, at 34. The average price of "new gas" was $2.46 per Mcf. *Id.*, at 35.

automatically authorize collection of the alternative price. This Court has recognized the difference between deregulated sales and sales subject to continued price controls that exceed current market levels. *See Martin Exploration Management Co.*, 486 U.S. at 209-211. However, the Commission based its rule on a reasonable reading of the NGA and NGPA, evolution over several decades of the "just and reasonable" concept, and studies in the record showing a tremendous loss of old gas even at the alternative ceiling price established by the Commission.[16]

II. THE ABANDONMENT PROVISION IS CONSISTENT WITH THE NGA AND THE NGPA, AND THE COMMISSION'S EVOLVING ABANDONMENT POLICY.

As with the alternative maximum lawful price ceiling, Order No. 451's abandonment provision represents an evolving policy favoring the use of market forces to regulate service. The Commission's decision to permit pregranted abandonment for contracts terminated under the rule is supported by the NGA and the NGPA, relevant decisions and the record.

The same market conditions that forced a re-examination of vintaging compelled the Commission to re-examine its abandonment policy under NGA Section 7(b). Before the market dislocations of the 1980s, the Commission em-

[16] In Order No. 451, the Commission acknowledges that "there can be no guarantee that the post-1974 price will remain market responsive . . . . the action taken in this rule represents a pragmaitc approach." Thus, the Commission foresaw the possibility that market prices might rise above the post-1974 rate. Order No. 451, *mimeo* at 96; R. 5488.

ployed the "comparative needs test" to determine whether to grant an abandonment; the Commission would compare the specific needs of the customers to whom service was to be terminated against the needs of the new proposed customers. In the 1980s, the Commission increasingly found the comparative needs test ill-suited to market conditions. In particular, the evolution of a short-term spot market necessitated a responsive regulatory scheme that would permit abandonment of sales and commencement of new sales without a lengthy regulatory review.[17]

In 1985, the Commission formally modified its abandonment policy in a departure from the "comparative needs test." *Felmont Oil Corp. & Essex Offshore Inc.*, 33 FERC ¶ 61,333 (1985), *reversed and remanded on other grounds, Consolidated Edison Company of New York* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987), *on remand, Felmont Oil Corp. & Essex Offshore Inc.*, 42 FERC ¶ 61,172 (1988). In *Felmont*, "[i]nstead of comparing the needs of the current consumers against the needs of identified specific new customers, the Commission announced that

[17] In 1983, the Commission began the evolution toward a new standard. In that year, the Commission first authorized special marketing programs ("SMPs"). These programs, issued on a company-by-company basis, provided for "blanket" abandonment, resale and transportation authority under NGA Section 7 for gas voluntarily released by pipelines to be sold to customers capable of switching to another fuel instead of gas. The pipeline would condition releases upon relief from contract take requirements. The programs were limited in duration. The District of Columbia Circuit invalidated and remanded the SMPs, not because of the generic pre-granted abandonment feature, but because the programs discriminated against so-called "captive" customers. Maryland Peoples Counsel v. FERC, 761 F.2d 768, 774 (D.C. Cir. 1985). On remand, the Commission developed its open-access transportation program on a generic basis in Order No. 436. The transportation program did not contain a feature comparable to the SMPs' generic pre-granted abandonment authorization, although the program did provide an expedited procedure for producer abandonment of old gas if the pipeline had substantially reduced its takes without payment. *See* 18 C.F.R. Section 2.77.

it would now compare the needs of the current consumers against the benefit that would accrue to the natural gas market as a whole were the facilities in question released from Commission jurisdiction." *ConEd*, 823 F.2d at 632.[18] In 1988, the Commission issued a generic abandonment rule.[19] The generic abandonment rule permits automatic pregranted abandonment of producer sales to pipelines if the parties mutually agree, the underlying contract has expired, or if the contract can be terminated at the option of one of the parties.

Seen in its proper context, the abandonment provision of Order No. 451 is a logical, incremental extension of the Commission's evolving abandonment policy. During

[18] The Commission quickly adopted the new *Felmont* policy in blanket certificates. These "limited-term abandonment" or "LTA" certificates authorized "the abandonment of sales by producers to pipelines of NGA-jurisdictional gas for a limited period, to the extent that such gas is released from contract by the original pipeline-purchaser. The released gas may then be sold by the producers to third parties on the spot market." Kansas Power & Light Company v. FERC, 851 F.2d 1479, 1482 (D.C. Cir. 1988). LTAs functioned in essentially the same manner as SMPs, except that (1) LTAs did not authorize transportation of the released gas (the Order No. 436 blanket open-access transportation provided the transportation component of the former SMPs) and (2) LTAs contained no customer restrictions.

After initially limiting LTAs to authorize abandonment only for gas priced above the Section 109 price (*i.e.*, Sections 102(d) and 108 gas), *see Tenneco Oil Co.*, 33 FERC ¶ 61,134 (1985), the Commission ultimately approved LTAs that permitted blanket pregranted abandonment of gas in all NGPA price categories, including all Section 104 and 106(a) gas. *See, e.g., Odeco Oil and Gas Co.*, 38 FERC ¶ 61,343, *reh'g denied*, 39 FERC ¶ 61,283 (1987), *aff'd*, KP&L v. FERC, *supra*. The inclusion of Section 104 and 106(a) gas in LTA authority enabled producers to combine the LTA authority with the Order No. 451 regulations to collect up to the Order No. 451 alternative ceiling price for gas released under an LTA, regardless of vintage, under any new contract entered into after July 30, 1988. Order No. 451, mimeo at 76-77, n.128; R. 5468-5469.

[19] Order No. 490, *supra*, n.12.

the initial restructuring in the 1980s, the Commission constantly re-examined its abandonment policy, in light of changes in the industry and careful court review. The Commission concluded in Order No. 451 that if the producer could not secure an adequate price for his old gas, he should be permitted to attempt to secure that price elsewhere, based upon the post-*Felmont* comparative needs analysis. Based on industry conditions, the Commission concluded that the "present" and "future" public convenience and necessity are satisfied by the rule.

As with the price aspects of the rule, Congress' nonintervention in the abandonment provisions of Order No. 451 is significant. The rule has been in effect four years; the Commission first permitted pre-granted abandonment more than seven years ago, in the SMPs; Order No. 490, the generic abandonment rule, has been in effect for more than two years. The 1989 Act provides for price and service controls to terminate as to old gas contracts effective with expiration, termination, or mutual release. In other words, the preconditions to abandonment under Order No. 490 now permit decontrol under the 1989 Act.

CONCLUSION

The Commission acted within the discretion afforded by Congress in enactment of the NGPA. Sections 104(b)(2) and 106(c) convey broad authority to eliminate old gas vintaging and to allow market forces to play a role in the establishment of prices for old gas. Moreover, the abandonment provision of the Natural Gas Act is sufficiently broad to authorize pre-granted abandonment in the manner provided for in Order No. 451.

For the reasons stated above, the Court should reverse the underlying circuit decision.

Respectfully submitted,

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